S. Hakala

analogy to a subsequent period, and so really the impact of that has to be measured by what happens in a later date when the alternative hypothesis or alternative type of scenario occurs.

Q. And how did you do that here?

A. By looking at subsequently what happens when the relevant truth comes out.

Q. But we're not comparing what would have happened on the 18th had CSFB disclosed whatever you view the relevant truth.

My question to you was what would have happened on the 18th had CSFB not said anything.

MR. HALL: Objection.

BY MR. GESSER:

Q. I'm asking you how do you test that.

A. Well, the way I test that is that's why the 18th and 19th events on 2001 are so important, because we have a stock trending down and then we have a small number of analysts countering the market's concerns and those counters to the market's concerns are having positive impacts.

S. Hakala

Q. So that's why the September 18th and 19th are so important.

A. Yeah.

Q. But were not included as event days in your AOL analysis?

MR. HALL: Objection.

A. That's correct. That analysis was really a fix of Dr. Kleidon's and that was an analysis where I don't think I went through the analyst reports at that level.

In fact I know I didn't even have the CSFB report at that time. I did not have the CSFB September 18th and 19th reports until later.

Q. You know that now that four years ago you didn't have it?

A. Yes.

Q. And the Bear Stearns report?

A. The Bear Stearns report we might have had but we might not have felt that that was strong enough by itself to put in because it was a reiteration of a buy, so it didn't even go into our event study by itself. So when we were doing our original screening, the Bear Stearns

S. Hakala

report did not even go into our event study.

Q. And April 18th, 2001, was that a reiteration of CSFB's rating and price target?

A. That was one aspect but it was not the primary thing. That's not all it was.

Q. What was it?

A. It was stating that the stock has been dropping because of concerns, the concerns are now fully priced and that AOL Time Warner was an early turnaround play.

Q. And did AOL report that day results, financial results that were above expectations?

A. Which day?

Q. On April 18th, 2001.

A. Oh, of course, yes. And they gave guidance, yes.

Q. Turning back to your rebuttal report.

A. Okay.

Q. Paragraph 3, I think this is getting back to what we described as being disclosure issues. In the middle of paragraph 3 you write, "The issue is whether the truthful statements would have significantly altered the stock price of AOL Time Warner"; is that correct?

S. Hakala

A. Yes.

Q. "And the two methods of demonstrating this are to show 1, that the disclosure of the relevant truth led to a significant negative effect on AOL Time Warner share price, and/or 2, whether other analysts -- when other analysts made similar types of statements there was a corresponding effect on AOL Time Warner share price."

A. Yes.

Q. What are the truthful statements that you're referring to here?

A. Disclosures AOL's planning layoffs would be one.

Q. Okay?

A. Disclosure that the ad revenue market is weakening, that AOL is unlikely to meet its earning targets and revenue targets in 2001 would be another.

Q. Did you view this as separate or the same?

A. Separate. Separate issues.

Q. Sorry. AOL layoffs is one. Ad market revenue, ad revenue market weakening is

S. Hakala

two.

A. Margins for AOL, AOL Time Warner are going to be difficult to maintain is three.

Q. Okay.

A. AOL Time Warner was involved in -- AOL was involved in questionable accounting with regard to transactions and reporting of revenue in such a way that the quality of its revenues and earnings was suspect.

Q. Okay. That's four.

A. And then you could put on it that well, in the case of CSFB, the price target is lower than the price target that they're recommending and that as a result -- and they also -- we've already sort of picked up the fact that their earnings quality is low and that they're likely to miss their earnings targets in the future.

Q. Is that six?

A. That's five.

Six is really incorporated above so it's redundant.

So I think it's five that I can think o off the top of my head.

S. Hakala

Q. Let me see if I can reiterate these so we got them.

One is layoffs.

Two is the ad revenue market has weakened.

A. Yes.

Q. Three is that AOL margins are going to be difficult to maintain.

A. Yes.

Q. Four is that AOL has engaged in questionable accounting with regard to certain transactions.

A. And reporting of earnings.

Q. And reporting of earnings.

A. Such that the quality of its earnings at various measures is lower than indicated.

Q. Okay. And five is that the price target --

A. Is too high.

Q. By -- the CSFB reported price target is too high.

A. Is too high. The market can't support that price.

Now on the ad revenue slowing, I

S. Hakala

think you're probably missing the second part to that and that as a result, AOL Time Warner was unlikely to meet its earnings guidance in 2001, 2002.

Q. Okay. So those are the five -- that's the truthful statements that had they been disclosed in the CSFB analyst reports would have caused AOL stock to decline in your view?

A. Significantly, yes.

Q. Significantly. Okay.

And you reached that conclusion because either that information was disclosed by AOL at some point, which coincided with a negative stock price movement for AOL, or --

MR. HALL: Objection.

Q. -- it was disclosed by other analysts resulting in a negative stock price reaction from AOL; is that correct?

MR. HALL: Objection.

A. That's the primary basis, yeah.

There's also some instances where analysts make positive statements rebutting those concerns and the stock moves in a positive direction on at least a handful or at least a

S. Hakala

few occasions.

Q. And how would that, how would that show -- what's the significance of that?

A. That shows when the market is concerned about those things, when information is leaking into the market suggesting there's a concern that analysts are going to have to lower price targets and that will impact the stock or that AOL might miss earnings targets, that when certain analysts come out and reinforce the company's guidance and say we think the guidance is still good, that's in a sense reinforcing and re-inflating the stock price, so it's the converse of the negative event.

In other words, when the market -- when information is leaking into the market causing the stock price of AOL Time Warner to fall, certain points such as September 18, 19, such as a couple of really good examples later in 2002 when an analyst denies those concerns, the stock goes back up.

Q. And what does that tell you?

A. That tells you that individual analysts have an impact on the stock price,

S. Hakala

especially when they speak to address or allay concerns in the market.

Q. And how do you test for that?

A. Did those allaying of concerns, in those instances at least, cause the stock price to go up, did it break a trend going down, was the movement significant.

Q. Okay. So let's start going through these and seeing how you reached your conclusions with respect to each of these.

In order for this to be what we're going to call a truthful statement, this needs to be something that CSFB analysts were aware of; is that correct?

A. Yes. Well, from a liability standpoint.

Q. I'm not sure what you mean by that.

A. Well, there can be truthful statements but it doesn't need CSFB to be aware of it.

Q. But for the purpose of your analysis here to determine whether -- I thought we had established that the CSFB, the CSFB analyst reports in your view had an impact on the stock

S. Hakala

price because it failed to disclose certain things.

MR. HALL: Objection.

A. Not just.

Q. No, I understand that.

A. It also prevented the stock from falling because it allayed concerns that were in the market and had CSFB not continued to provide reinforcement, the stock might have fallen more.

Q. We've already been through that, yes.

A. Okay.

Q. In part because, in part because they failed to disclose certain things, correct?

A. Yes.

Q. Assumption is that the CSFB analysts were aware of these things that they failed to disclose; is that correct?

MR. HALL: Objection.

A. Yes, as I read them in the complaint.

Q. Okay. So the first issue is layoffs.

A. Okay.

Q. Okay?

How did you determine that CSFB was aware of layoffs at AOL?

S. Hakala

A. I assumed it as a fact as pled in the complaint.

Q. Okay. So can you show me where in the complaint --

MR. GESSER: Marking Exhibit 7 now.

(Defendants' Exhibit Hakala 7, Complaint, is marked for identification, as of this date.)

BY MR. GESSER:

Q. I think it's paragraph 68 that you're referring to.

(Witness reviewing exhibit.)

A. Okay.

MR. HALL: Actually, if you would like to review more of the complaint to refresh your recollection, please take your time to read it.

THE WITNESS: That's fine.

BY MR. GESSER:

Q. So is it paragraph 68 and 69 that are the source of your assumption that CSFB analysts were aware of layoffs at AOL?

A. From the complaint, yes. I understand there may be more evidence now that

S. Hakala

counsel has obtained, yes.

Q. Do you know anything about that evidence?

A. No, but I mean I'm just taking as a foundation at some point AOL -- CSFB's analysts knew about AOL layoffs or potential layoffs and knew that AOL was not going to disclose them.

Q. Let's start with layoffs or potential layoffs?

What does this say?

A. It says, "Had some layoffs today."

Q. Okay. Do you know of any other source of information that CSFB analysts had about layoffs other than that?

A. No.

Q. Okay. So what you know is that analysts at CSFB heard from a source at AOL that apparently the company had some layoffs; is that correct?

MR. HALL: Objection.

A. Yes.

Q. Do you know what the size of those layoffs were?

A. Later on we do, yeah.

S. Hakala

Q. Okay. What were they?

A. I don't know without looking at my report but it's in there.

(Witness reviewing exhibit.)

A. 1,000. About 1,000 employees.

Q. What makes you think that there were -- that this information that CSFB knew about these layoffs were 1,000 employees?

MR. HALL: Objection.

A. I don't know.

Q. You don't know what?

A. I don't know. I don't know how many people were laid off that day.

Q. So you just... Sorry. So when you said 1,000 employees, what were you referring to?

A. The Washington Post article on 8/14.

Q. Okay. So on 8/14 the Washington Post announced that there were 1,000 layoffs at AOL.

A. Yeah.

Actually 8/13 there's news that AOL is struggling to meet targets and that layoffs are expected, and the Washington Post reports an expected lay off of 1,000 employees.

S. Hakala

My understanding is that a lot of those employees were already laid off or that the news that they were being laid off was already out in AOL on July 10th, but I don't know that and it's just an assumption.

Q. That's just an assumption.

A. Yes.

Q. Where does that come from?

A. I don't know. I don't remember.

Q. Okay. But you view that these layoffs that are announced on April 13th or April 14th to be the same layoffs that are referred to in the July 10th e-mail; is that correct?

MR. HALL: Objection.

BY MR. GESSER:

Q. I'm sorry. The August 13th, August 14th news reports, the layoffs discussed in those news reports are the same layoffs referred to in the July 10th email in paragraph 68 of the complaint.

MR. HALL: Objection.

A. I didn't assume that they were exactly the same, no, but I assumed that this,

S. Hakala

the information that this is indication that AOL is struggling to meet targets and is having to lay off employees, that particular type of information was consistent with what you would have known on July 10th.

Q. Where does it say that AOL is struggling to meet targets?

A. That's in the Washington Post.

Q. But that doesn't appear in paragraph 68 or 69 of the complaint or the emails referred to therein.

A. No.

MR. HALL: Objection.

Q. Okay. So let's start again.

What did CSFB know in July 10th, 2001 about layoffs at AOL?

MR. HALL: Objection. Dr. Hakala is not here as a fact witness.

Q. What did you assume for the purpose of your analysis that CSFB knew about layoffs on July 10th, 2001?

A. That the company was starting to lay off employees; that while they didn't have exact details, as you'll see on July 11th, it was

S. Hakala

medium term in terms of severity, will not be announced publicly, and then it goes on talking about AOL is under investigation, okay?

So my understanding is that some of it may have even related to that issue, inappropriate accounting activities, but they were aware that this was not just, you know, a few people being let go because of something, it was a layoff of employees because there's not enough business to support those employees.

Q. Where does it say that?

A. Medium terms in severity. Medium terms in terms of severity. Layoffs are not just -- I mean they're layoffs. That means that you're not growing, you don't have enough business to support your staff.

Q. Does the market ever react positively to news of layoffs?

A. Only if they occur after the market has already anticipated that the company is suffering a decline in revenue and sales. Then layoffs which reduce costs which investors felt were long overdue will cause a positive reaction.

S. Hakala

Q. And that's the only time layoffs will result in a positive reaction?

A. That's the primary time. I can't say it's the only time.

Q. Okay.

A. But any type of restructuring where it is after investors have already anticipated bad news will tend to have a neutral or positive effect, whereas layoffs or news of layoffs before the market has anticipated failures to meet targets or guidance will tend to have a negative effect.

Q. And in this circumstance, the news about AOL in July 2001 was generally positive or generally negative?

A. It was mixed, but generally positive in the sense that AOL was still maintaining targets and AOL was still suggesting that it's continuing to grow.

Q. And if CSFB had disclosed exactly what was in this email, that it had learned from a source at AOL that the company had some layoffs of medium severity, what would AOL's stock price have done in response to that?

S. Hakala

MR. HALL: Objection.

BY MR. GESSER:

Q. In your view.

A. Fallen.

Q. And how do you reach that conclusion?

A. By looking at what it did on 8/13 and 8/14 when some of the news leaked out.

Q. Okay. So let's take a look at those reports.

(Defendants' Exhibit Hakala 8, The Wall Street Journal article dated 8/13/01, is marked for identification, as of this date.)

BY MR. GESSER:

Q. Do you recognize this --

A. Yes.

Q. -- article?

This is The Wall Street Journal August 13th, 2001 article discussing layoffs --

A. Yes.

Q. -- at AOL?

And just so I understand, you're saying that you know that had CSFB disclosed what it knew about layoffs on July 10th, 2001,

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it would have had an effect on AOL's stock price because on August 13th when AOL announced layoffs, there was a negative effect on AOL's stock price; is that correc5?

MR. HALL: Objection.

A. That's not the sole basis. There's more to it than that.

Q. Okay. Well, let's start with do you view that the layoffs announced on August 13th are the same kind of layoffs discussed in the July 10th report, on the July 10th email or the exactly the same layoffs?

A. Same kind or the same kind of inference would be drawn from them.

Q. So they are not the same layoffs.

MR. HALL: Objection.

BY MR. GESSER:

Q. In your view.

A. I don't know.

Q. You don't know if they're the same layoffs?

A. I don't know.

Q. But you do know that --

A. I believe that there is an overlap,

S. Hakala

but I don't know for sure.

Q. Okay. In the July 10th email, the layoffs had already occurred; is that correct?

A. Yes.

MR. HALL: Objection.

A. Or at least people were given notices. I don't know that they were actually let go.

Q. But it said, "The company had some layoffs today."

A. Yes.

MR. HALL: Objection.

Q. That's July 10th, 2001. Is that what the email says, "The company had some layoffs today"?

A. Yes.

Q. Okay. What does the first line of the August 13th, 2001 Wall Street Journal article say?

A. "It's expected to announce a round of substantial layoffs on its -- at its online unit according to some people familiar with the situation."

Q. And the last paragraph starts with,

S. Hakala

"The round of cutbacks at America Online division is expected to involve hundreds of employees"?

A. Yes.

Q. So what makes you think that this round of layoffs which appear to be occurring in the future are the same layoffs that had apparently already occurred on July 10th, 2001?

MR. HALL: Objection.

A. Because this says they are not going to disclose it, they were of medium immediate severity and this disclosure only talks about layoffs associated with the merger in January. It doesn't indicate there are any layoffs had occurred in the interim. So clearly what was -- I mean there is multiple alternative scenarios.

One is on July 10th, CSFB was aware that certain people were being told they're going to be laid off but hadn't actually been laid off or hadn't either yet lost their jobs, and so AOL came out and announced on August -- sometime after August 13th when the word street leaked out to The Wall Street Journal and other sources that these layoffs were coming.

S. Hakala

Q. You're just speculating. You don't know that.

MR. HALL: Objection.

A. Well, first of all, I'm not a fact witness.

All I'm saying is it's alleged in the complaint that CSFB was aware that there were layoffs occurring in AOL.

I'm telling you that if you announce layoffs are occurring in an entity where the company is still giving positive guidance and growth for that entity and before an earnings announcement, that's going to have as much of an effect and we know that even after a disappointing earnings announcement of lowering guidance when layoffs were leaked into the market it had a negative effect.

Q. Let's start with the first question which I'm asking of you, which are these the same layoffs?

MR. HALL: Objection. Asked and answered.

Q. Are --

A. I don't know for certain, but it's my

S. Hakala

assumption that they are or that they are of similar type.

Q. Okay. Did you look to see if the earlier announcements of layoffs at AOL that are discussed in this report, the 2,000 jobs that were cut in January, did you look to see whether they had a positive or negative impact on the AOL stock price?

A. I did look at that as part of the merger, but my understanding was that was a consolidation due to merger synergies and that those were anticipated sometime in 2000. So the impact was muted because it was already known that some people were going to be let go because when you consolidate two large media conglomerates, you naturally knock out some employees, some redundancies.

Also, that occurred at a time when there was a lot of news about the merger.

Q. Was the August 13th -- was August 13th, 2001 a day in which there was a statistically significant negative movement in the AOL stock price?

A. Yes.

S. Hakala

Q. How did you determine that?

A. Statistics 1.71. The statistics for a one-tail test is 1.65 for standard significance. If I use a 10 percent threshold or P value, which is accepted in this type of scenario, even on a two-tail test that would be statistically significant.

Q. And that's just for August 13th.

A. Just August 13th.

Now the 14th --

Q. Close to close or close to open?

A. Close to close.

Actually it's last price to last price, but at this point in time the Bloomberg data is pretty much close to close.

Q. But you, in your rebuttal report you look at both days together, August 13th and August 14th.

A. Yes.

Q. Why do you look at the two days together?

A. Because it's a leakage event. It's not a confirmation by the company and the first day reveals some of it, says it's in the

S. Hakala

hundreds. The second day, Washington Post comes out with a more detailed story and says that it's expected to lay off 1,000 employees and it's a further confirmation.

So when we have leakage events, when two different credible sources report back to back over two days, we would look to see what the effect is on the first day and the second day separately and then we would look at it together.

It's pretty well-known that when you have leakage, that the impact tends to come in as the information leaks in and as each new source adds additional credibility to the story.

Q. And so there's something qualitatively different about hundreds of employees in The Wall Street Journal article versus 1,000 employees in The Washington Post article?

MR. HALL: Objection.

A. I would think so. Not to mention qualitative, even if The Washington Post was merely confirming The Wall Street Journal article, the fact that you have two reasonably

S. Hakala

reputable news sources both reporting on the same rumor back to back will have an impact each day.

The Wall Street Journal could have been wrong, but when The Washington Post comes out the next day and gives further information and confirms it, it's much less likely The Washington Post was wrong.

Q. And did The Wall Street Journal article come out before or after the market opened on the 13th?

A. Before.

Q. Did you do a close to open analysis for the July -- for August 13th?

A. Let me check.

(Witness reviewing exhibit.)

MR. HALL: The AOL report.

THE WITNESS: Well --

MR. HALL: Never mind.

THE WITNESS: The overnight --

MR. HALL: Okay.

THE WITNESS: -- event study appears in Hakala Exhibit 5. The affidavit in the original AOL Time Warner has an overnight

S. Hakala

basically close to open event study and I'm looking in here, and for some reason whoever printed this out -- oh, I see. The exhibits are at the back.

(Witness reviewing exhibit.)

A. No, it's not showing here.

I think if I pulled the actual file, I believe it is showing up in the file. There's an open -- a close to open event study.

Q. And would you expect there --

MR. HALL: Can I just ask for clarification?

Because Dr. Hakala was looking at his report affidavit that he had prepared in the In Re AOL Time Warner class action and I believe Mr. Hakala was referring to the event study performed in that analysis.

THE WITNESS: Yes. For the layoff issue I believe that we -- where we knew that the events occurred overnight, we did a close to open event study.

BY MR. GESSER:

Q. Would you expect that close to open event study to show a statistical significant

S. Hakala

negative movement in the AOL stock price as a result of The Wall Street Journal article which was released in the market before the market opened on that day?

A. A priori yes, but I don't know to what extent it would have.

Sometimes an article comes out and the market sort of digs around and confirms it during the day.

Sometimes the effect is felt overnight and then if the company denies it, the stock rebounds.

So the answer is a priori generally yes, but not always. With leakage events you can never be certain.

I mean I know of a case where The Wall Street Journal came out with a scathing article that revealed the truth. The stock didn't drop hardly at all and then the next day there was confirmation of it and the stock dropped dramatically, so it can go both ways.

MR. GESSER: Marking Exhibit 9.

(Defendants' Exhibit Hakala 9, Overnight Close to Opening Event Study, is

S. Hakala

marked for identification, as of this date.)

BY MR. GESSER:

Q. Do you recognize this document?

A. Looks familiar.

Q. Can you tell me what it is?

A. It is probably the overnight close to opening event study that I did originally earlier on and so it's the full detail.

Q. So for close to open for August 13th and August 14th, is there a statistical significant price movement of AOL stock?

A. No.

Q. What makes you think that the layoffs as opposed to other negative news was the cause of the drop in AOL stock price on August 13th and 14th?

A. Other news sources say it was.

Q. For example? Do you know what news sources those were?

A. Not offhand without going through the file, but I remember specifically that, you know, something like that where there might be a question, first we would look to see if there's

S. Hakala

any other news that's at all credible in that time period.

Second we might look at things like usually there's like CNBC or Nightly News, Business News Report or some other report in the evening that will say or like Bloomberg will say AOL stock price dropped today for this and such and such a reason. Maybe there's an analyst report that says AOL stock dropped yesterday because of this so...

Q. There may be --

A. But it could have been a lot of different things.

In fact it may be that I found some analyst reports later in the day on the 13th that confirmed the rumor or acknowledged the rumor.

Q. But it may be but you don't know.

A. Not without going through the file, but if I went through the file I could tell you exactly.

Q. You're sure that you could tell me that exactly?

A. Yeah.

S. Hakala

Q. Okay. So where was that file?

A. I don't know.

Q. Could you during the lunch break find someone to find that file for you and find that information?

A. Probably not without going to the office.

Q. Okay. But there was other negative news that reached the market on April 13th and 14th; is that correct?

MR. HALL: Objection.

A. Other than the layoffs?

Q. Other than the layoffs.

A. Not that I know of.

Q. Okay. If you take a look at the document we just marked, The Wall Street Journal article.

MR. HALL: Hakala-8.

THE WITNESS: Did we mark Hakala-8?

(Witness reviewing exhibit.)

BY MR. GESSER:

Q. It says, "The move comes as the media conglomerate is struggling to meet its financial targets amid a deteriorating advertising

S. Hakala

climate."

A. Yeah.

Q. Would you view that as negative news?

A. No.

Q. Why would that not be negative news?

A. That came out in July. That's what July was about.

Q. Does it --

A. This isn't new. This is something that came out in July. That's what the July 19th analyst reports were about. That's why the July 19th Analyst reports caused the stock to fall.

Q. So that news was -- the news that it's struggling, the market was already aware of that?

MR. HALL: Scott, let me ask you to read the third paragraph down on Exhibit 8, see if that refreshes your recollection.

(Witness complies.)

A. No, I know. No, it's pretty clear. This is commenting on what's already known. The layoffs were not was already known.

Q. Sorry. Just bear with me as I...

S. Hakala

MR. GESSER: Okay. We're up to 10. Exhibit 10.

(Defendants' Exhibit Hakala 10, Financial Times article dated 8/14/01, is marked for identification, as of this date.)

BY MR. GESSER:

Q. It's a Financial Times article.

If you look at the bottom, its load date is August 14th, 2001?

A. Yes.

Q. If you look in the middle of the article it says, "Mike Kelly, chief financial officer..." and it's the chief financial officer of AOL, "...told investors during the second quarter conference call that AOL Time Warner would 'seek to drive cost efficiencies and keep a keener view on costs'."

Do you see that?

A. Yes.

Q. Okay. Would you agree that that is news about AOL?

MR. HALL: Objection.

A. In the second quarter conference

S. Hakala

call, yeah.

Q. Do you know when the second quarter conference call took place?

A. July 18th.

Q. That's when it took place?

A. Yeah.

Q. Okay. Do you know of any analyst reports that came out to the market on August 13th or 14th?

A. There may have been some, but if they were, they were only talking about this issue and we didn't view them as incrementally being the focus of that day.

(Defendants' Exhibit Hakala 11, Morgan Stanley analyst report dated 8/14/01, is marked for identification, as of this date.)

BY MR. GESSER:

Q. Do you recognize this document?

A. Yes.

Q. Can you tell me what it is?

A. It's Morgan Stanley analyst report on the 14th of August.

Q. It's a change in forecast for Morgan

S. Hakala

Stanley on AOL?

A. Yes.

Q. It reduces its 2001 and 2002 forecasts?

A. Yes.

Q. Do you see any discussion about layoffs?

A. Yes.

Q. Where is that?

A. It's on page 3.

Q. Okay. What does it say?

A. It says, "There have been recent press reports that AOL is looking at potential layoffs. We believe that these potential moves relate to the ongoing strategy of streamlining product development and elimination of duplicative capabilities across divisions."

Q. Okay. It's not -- that doesn't appear on the front page of the report; is that right?

A. No.

Q. Would you view this report as being negative --

A. Yes.

S. Hakala

Q. -- with respect to AOL?

A. Yes.

Q. Okay.

A. Yeah, ordinarily it should be in the event study.

Q. So how -- for the 14th, how can you tell whether it is the news of the layoffs or this analyst report reducing forecasts that had a negative effect on AOL stock price?

MR. HALL: Objection.

A. Unless you can do some kind of intraday and break out the timing, it would be difficult to see one versus the other, which one is the more predominant in terms of its effect.

It's also possible, and this happens a lot, that Morgan Stanley put this report out precisely because the layoffs provide a cover to do what it wanted to do.

Q. But you didn't do the intraday study?

A. No. No, not at this stage.

Q. Okay.

MR. GESSER: We're up to Hakala-12.

(Defendants' Exhibit Hakala 12, Salomon Smith Barney equity research report

S. Hakala

dated 8/14/01, is marked for identification, as of this date.)

BY MR. GESSER:

Q. I'm showing you a Salomon Smith Barney equity research report from August 14th, 2001.

A. Yes.

Q. And in that report Salomon Smith Barney is reducing estimates for AOL?

A. Yes.

Q. Again, the market may view this as negative news?

MR. HALL: Objection.

A. You know, that's difficult. You know, sitting there and speculating about what the market -- because this is really mixed. I mean they say expanding margins and prospects and they're only trimming their forecasts a little bit but they're saying with cost-cutting momentum.

You know, it may be that the market already expected analysts to belatedly reduce these targets and these EBITDA targets based on what had happened already in July, so maybe this

S. Hakala

analyst was late in the game, but this might actually not be viewed as so bad. It might even be viewed as a bullish report.

Q. But you think the layoffs would be viewed as bad.

A. I think in the context of the way that they came out on the 13th and 14th, I think the news around that time suggested to me that it was concerns that the layoffs signaled a deeper problem at AOL, that it was being concealed.

In other words, it was not coming from AOL, it was coming out from a third source that was of a particular trouble to investors.

I mean if AOL would have come out and said we're just cutting costs and this is for synergies, it may not have had the same impact or it might have had the same impact or even a greater one because it might very well have been that people would have said well, you know, you're not cutting 1,000 employees just for cost cutting, that's a sign that you're having trouble.

MR. GESSER: Marking Exhibit 13.

S. Hakala

(Defendants' Exhibit Hakala 13, The Wall Street Journal article re Warner Brothers, is marked for identification, as of this date.)

BY MR. GESSER:

Q. So Wall Street Journal article announcing that Warner Brothers is going to close its 85 owned and operated retail stores by October.

Is Warner Brothers a subsidiary of AOL Time Warner?

A. Yes.

Q. Okay. And if you look in the fourth paragraph, "The spokesman for Warner Brothers said the company management decided to exit from its retail operations and the stores were in a wind-down phase. The closing resulted in layoffs of about 3,800 employees."

A. Yes.

Q. And were you aware of this article?

A. I don't know. I didn't see it in my event study. Ordinarily I would put this in my event study.

Q. Okay.

S. Hakala

A. I'm not sure why it didn't go in.

Q. Do you know what the market reaction was to this announcement?

MR. HALL: Objection.

Are you talking about on this day or at an earlier time?

MR. GESSER: On this day.

A. I don't know.

I do know that this was not unexpected. I think that the wind down and the problems in the Warner Brothers stores was something probably known prior year. I mean this is a division that was struggling.

Q. Turning -- so is there any other evidence that you have that, other than what happened on the 13th and the 14th of August, 2001, that had CSFB disclosed the information about layoffs that it received in an email on July 10th, that that would have had a negative impact on the stock price?

MR. HALL: Objection.

A. I thought there was one more.

(Witness reviewing exhibit.)

A. That's the primary.

S. Hakala

There is a small additional negative reaction on 8/22/01, but it's, it's -- in light of the leakage, it's not incrementally significant.

Q. And what was the news event that occurred on 8/22/01?

A. AOL then confirmed it planned to cut 1,700 jobs and to take a charge, and there was also a CSFB report. I think the report and some of the other news on that based on some of the other analyst reports I think tried to put somewhat of a positive spin and neutralize some of the effect, especially after the news had really leaked out earlier.

Q. Okay. Turning to No. 2 on our list of the truthful statements, which the ad revenue, the ad market, the revenue from the ad market was in decline.

A. Yes.

Q. I'll let you characterize it however you want to.

A. That advertising revenue was failing to meet expectations, that it was a tough environment, and that AOL Time Warner were

S. Hakala

therefore unlikely to meet revenue and earnings expectations, especially beginning the second half of '01.

Q. And what specific facts about the advertising market and AOL's revenue from the advertising market were known to CSFB analysts but not known to the market?

MR. HALL: Objection.

A. Where's the complaint?

(Witness reviewing exhibit.)

A. I thought that -- this really starts in the complaint, which is Hakala Exhibit 7, on page 8.

Q. Hakala Exhibit 7.

A. Actually it really begins earlier.

Q. Let's make sure we're on the same page here.

A. Basically on January 12th, 2001, it says what's important that I don't say in my earnings preview is that the national ad market is much weaker than five weeks ago.

Q. Okay. And who's speaking there?

A. Martin.

Q. And you viewed this as being

S. Hakala

something that she knew that the rest of the market didn't?

A. She knew much more than the market did and knew that it was going to have an impact on AOL, yeah.

Q. How did she know that the advertising market, the revenue-- well, let's see exactly what she says.

"The national ad market is much weaker than five weeks ago."

A. Yeah.

Q. Okay. This is something that Laura Martin knew that the rest of the market didn't know.

MR. HALL: Objection.

A. Possibly.

Q. How would she know this? How would she know something that the market didn't know about the national advertising?

A. She's a media analyst. She's checking channels, she's talking to insiders, she's gaining information.

Q. Do you think she has access to non-public information?

S. Hakala

A. It's entirely likely.

MR. HALL: Objection.

A. Yeah. It's part of her job.

Q. Okay. Do you have any -- can you think of any specifics as to what she would know that other people wouldn't know about the national ad market?

MR. HALL: Objection.

Again, I would say you're talking to what a defendant in this case knew which are questions of facts that will be up to a jury to decide at some point in time.

Dr. Hakala is here to give his opinion on the economics study performed.

MR. GESSER: Okay. But he's making factual assumptions and one of the factual assumptions that he's making is that Laura Martin had access to non-public information about the ad market or she knew something about the ad market.

A. That was not reflected in her reports and not necessarily reflected in the reports of other analysts.

Q. My question to you right now is what

S. Hakala

did she know about the ad market that the rest of -- that the market didn't know?
MR. HALL: Objection.
Q. In your opinion.
A. I didn't study that, but it was my understanding that generally insiders at the marketing firms knew that the ad market was weaker than investors and let's say the broader audience knew by probably a month to two months.
Q. Did other analysts know what Laura Martin knew about the ad market?
MR. HALL: Objection.
We don't know what --
A. Probably, but I don't know.
Q. You don't know.
But what would cause you to believe that Laura Martin knew something about the national ad market that nobody else knew?
MR. HALL: Objection.
A. What's important that I don't say in my earnings preview is that the national ad market is much weaker than five weeks ago. If everybody else knew, why wouldn't she just put it in there?

S. Hakala

Q. I'm asking you what makes you think she knew something --
A. No, you're arguing with me about facts.
I'm saying that's a reasonable inference and I'm drawing an assumption based on the complaint.
Q. You're drawing an assumption that Laura Martin knew something about the national ad market that nobody else knew.
MR. HALL: Objection.
A. I don't know if nobody else knew.
I'm saying that if it was widely known, I would have anticipated her to put it in her report and not to conceal it, and the implication of this and the way it's pled is that this is information that she knew that she concealed in her report.
I'm drawing the reasonable inference and the assumption that that means that she has knowledge of something that's not as widely known and that if she put it in her report, that would have been important information.
We know subsequently that when the

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Lehman analyst made similar statements of a similar type in a report, that it did move the stock market, so for whatever reason, media analysts apparently have some knowledge about the ad market that might give them some front-end or timing advantage over the broader market and other people.
Q. Well, let's try and distinguish between what Laura Martin knows and what her opinions were.
MR. HALL: Objection.
I would just state on the record that we don't know what Laura Martin knows. All we know is what she said in emails. Until we take her deposition, we won't --
Q. Assumptions that you're making about what Laura Martin knew versus assumptions that you're making about what Laura Martin's opinion was.
Are there instances in which Laura Martin said that she knew something where they turned -- about what was going to happen at AOL which turned out to be incorrect?
A. I don't know.

S. Hakala

MR. HALL: Objection.
Q. Okay. So let's turn back to the complaint.
What are other examples of things that you assumed Laura Martin knew that weren't known to the market?
A. January 12th email, the report includes five forms of valuation, each of which concludes this company is worth 60 to $65 a share. I couldn't find a way to justify an $80 price target.
Q. So she knew that the CSFB price in your -- so what does that mean? What did she know?
A. She knew that when she did five different forms of valuation analysis and took into account her understanding of where the market was in terms of growth prospects and earnings prospects that she cannot get a price target or value for AOL Time Warner above 60 to $65 a share.
Q. And the market didn't know that.
A. I don't think the market knew that.
Q. When did the market learn of that?

S. Hakala

MR. HALL: Objection.

A. Probably that particular issue in the lowering price targets in -- some of that leaked out in March and April with concerns generally, and some of that came out in July, August of '01.

Q. Some of what?

A. That fact that price targets were too high. The valuations couldn't support that.

Q. That the market learned that Laura Martin didn't think that AOL could hit its $80 price target?

MR. HALL: Objection.

Q. That came out in the market at some point?

A. At some point. At some point CSFB lowered its targets.

Q. But what would the market -- the market would only know at that point that CSFB lowered its targets; isn't that right?

MR. HALL: Objection.

A. Yeah. If you're asking did the market know that Laura Martin committed fraud, no, but that's not the relevant inquiry.

S. Hakala

The relevant inquiry is when did the market learn the relevant truth, and that is that the value of the stock at $80 a share can't be supported. The market -- you know, loss causation doesn't require a mea culpa.

Q. But I'm asking you what facts Laura Martin knew that weren't disclosed in the market, and one of the things that you said was that five forms of valuation, each of which concluded the company's worth 60 to $65 a share, that's a fact that the market didn't know.

And I asked when did the market find out that Laura Martin had done five forms of valuation, each of which concludes the company is worth 60 to $65 as of that time?

MR. HALL: Objection.

A. I don't think the market ever learned that she did that, but the market learned that you couldn't support the valuation in her report at some point.

Q. And when did the market learn that?

A. Progressively over time. Some concerns about advertising revenue in March and April and then significant concerns probably

S. Hakala

May, I'd have to go back and look, May, June, July and August of '01.

Q. But in that time period events had changed at AOL; is that correct?

MR. HALL: Objection.

A. Some events had changed, but the trends and the handwriting was already on the wall before the merger even hit.

Q. And at that time AOL's stock price was artificially inflated.

A. Yes.

Q. As a result of things that AOL had done.

MR. HALL: Objection.

A. In part, yes.

Q. What other facts were known to Laura Martin that were not disclosed?

A. That the return on invested capital model is not really showing that the company is earning eight percent. It's closer to five percent when they do the newly combined numbers. That's in paragraph 21.

Q. That's about CSFB's own internal model; is that correct?

S. Hakala

A. Yeah, but what it's really saying is that the combined return on invested capital at AOL Time Warner is not as high as being reported.

Q. What else?

MR. HALL: Did you want Dr. Hakala to go through the complaint paragraph by paragraph?

MR. GESSER: Well, yes. I'd like him to tell me all the things that Laura Martin knew that the market didn't know.

MR. HALL: Objection.

MR. GESSER: That he's relying on. We're talking about he had indicated that there are things that needed to be disclosed in the CSFB reports and I'm trying to get an assessment of what it is that needed to be disclosed that the market wasn't already aware of, and some of these things relate to CSFB's only internal price target selection and so forth and I'm asking him what else needed to be disclosed.

MR. HALL: Well, I mean I understand

S. Hakala
what you're asking him, but he's also said that what he did was assume our allegations about these certain areas, and he looked at them to confirm that it was a fair inference, were accurate.
It's up to us and lawyers and fact finders to determine whether or not we're right about what Laura Martin knew and I think you're getting far afield from an economic study.
BY MR. GESSER:
Q. What allegations in the complaint did you rely upon in making a determination that there were things that needed to be disclosed in the CSFB report?
A. Once again, defendants failed to disclose the known risk that advertising market was substantially weakening and that therefore -- and therefore that AOL would be unable to achieve revenue and earnings guidance published by defendants for AOL.
Q. Okay.
A. Additionally that because of that, they could not support the price targets in

S. Hakala
their report.
Q. Okay. So the risk to the advertising market was known or was not known?
A. By who?
Q. By the market.
MR. HALL: Objection.
A. Not fully.
Q. Not fully.
A. But the market did not fully understand the trends in the advertising revenue as well as industry insiders and some analysts who had some internal access knew. I think that's pretty clear in retrospect.
If you look at investor comments, analyst reports and then you look at what was known sort of internally in this time period, I think it's a number of the media cases have clearly indicated that there was a discrepancy between what the market believed and what internally some analysts and certainly company insiders believed.
Q. Believed or knew?
MR. HALL: Objection.
A. Knew, because with advertising

S. Hakala
revenue you already know what you're facing in terms of contracting for revenue, what the demand for site space is. These contracts are you're contracting in advance, you're negotiating in advance.
Q. So keeping with the last sentence of paragraph 22 of the complaint which you just read, it says, "And therefore that AOL would be unable to achieve the revenue and earnings guidance published by defendants for AOL."
Are you saying that --
A. Yes.
Q. -- Laura Martin knew that AOL would be unable to achieve the revenue and earnings guidance or Laura Martin thought that AOL would not be able --
MR. HALL: Objection.
A. I don't know. I didn't splice the hairs that fine and I'm not sure it really matters.
I just assumed that whether she thought or knew, as an analyst she can't go out and put out a strong guidance or give guidance that says, you know, we think they can still

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meet it, because later on she says we think they can still meet guidance with a price increase in AOL for subscribers, which AOL in fact did do.
You know, when she knows internally or thinks, that's not possible. I mean that's kind of like okay, whether she knew or thinks, I'm not sure how you parse that out.
Q. But Laura Martin didn't have a crystal ball and she couldn't know whether AOL would meet its guidance or not.
MR. HALL: Objection.
A. Well, you're talking about couldn't know for certain or couldn't have a very high degree of confidence that AOL's numbers are inflated at that time contemporaneously, and that given the trends and given what she was seeing in terms of forecast for the market, AOL is not going to meet its guidance.
Now that doesn't mean that something dramatic couldn't turn around the market in the next three to six months.
Q. So you would agree that she couldn't know for certain.
MR. HALL: Objection.

S. Hakala

A. Of course. She doesn't have a crystal ball, but she can know for certain that the current forecasts that are being put out based on her models were inflated and were not realistic.

Q. And was there any time when Laura Martin thought that AOL couldn't meet its numbers when they in fact did meet their numbers?

MR. HALL: Are you talking before or after the statement of the financials that had been --

MR. GESSER: During the class period.

MR. HALL: One second. I just want a clarification.

Are you talking about --

MR. GESSER: During the class period.

MR. HALL: What do you mean by their numbers, though, during the class period. They have now restated financials back into the class period that would lower what they actually reported.

MR. GESSER: My question is when Laura Martin said that AOL couldn't

S. Hakala

meet its -- she thought that AOL couldn't meet its numbers, was there any time in which AOL in fact did meet its numbers when it announced the next quarter.

MR. HALL: Including or not --

MR. GESSER: That's the question.

MR. HALL: Including or not including the accounting fraud that was taking place?

MR. GESSER: That's my question. If he has a question about what -- if he's unclear about it, you don't have to prompt him with the stuff.

MR. HALL: I'm not prompting.

MR. GESSER: Yes, you are.

MR. HALL: I'm trying to get your question clarified because --

MR. GESSER: Just make your objection and then --

MR. HALL: I'll make my objection.

MR. GESSER: Okay. Thank you.

MR. HALL: We'll go through this but I object because you're being vague because you're trying to mislead. You're asking a misleading question.

S. Hakala

MR. GESSER: If he doesn't understand the question --

MR. HALL: Let me get my objection. It's a misleading question because it's misstating --

MR. GESSER: No, no, no. You're objecting because you're trying to prompt him with information.

MR. HALL: -- facts related to AOL. I don't need to prompt Dr. Hakala. That's one thing for sure.

MR. GESSER: So then all you need to do is just make your objection.

(Witness reviewing exhibit.)

A. I think the first quarter of 2001, my understanding and reading between the lines of what I know is that AOL might have met or fallen just barely short of expectations. I think that actually probably did surprise Laura Martin but I don't know.

Q. Because she thought they wouldn't make it.

A. Yeah, but I don't know.

I mean I do know in retrospect that

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the only way that AOL pulled that rabbit out of the hat has to do with other things. I mean they were pulling a lot of rabbits out of the hat in those quarters.

Q. Now with respect to AOL not being able to meet its numbers, you view a disclosure by CSFB as to their opinion about whether AOL could meet its numbers as being qualitatively the same or qualitatively different in terms of materiality from AOL actually disclosing that it did not meet its numbers?

MR. HALL: Objection.

A. That's qualitatively different, but impact-wise, the distinction between those is often not distinguishable.

In other words, if an analyst five days before an earnings call comes out and says I don't think this company is going to their numbers, they're going to fall short, it is not uncommon for the stock to drop as much then or more than what happens when the company comes out and says we're going to meet our earnings.

In fact, sometimes --

Q. Can you give me an example of that?

S. Hakala

A. Yeah, but I'm trying to think of a case, an example.

Q. Did that happen here in any instance? Can you give me an example here where an analyst said that AOL was going to meet its numbers and the stock dropped significantly, and then when AOL actually didn't meet its numbers, the stock didn't drop because the market was already aware of that?

A. I think that happened in April 2002. I'll have to look at that, but there are one or two quarters where in fact that did happen.

I think that happened also before this period. We had this happen in I think October of 2000 AOL doing that.

We also have -- there's a couple of instances where that happened.

4/25/02 is a good example of one where the stock actually went up and the analyst anticipated it and they were all cutting and slashing targets.

In fact here you'll see 4/16, 4/22, 4/23 and then 4/10 analysts are just slashing the stock price and progressively the stocks

S. Hakala

getting knocked down, and then when AOL actually comes out and announces earnings, it's not so bad and the stock actually goes up a little.

Q. And that's several analysts --

A. Yeah, but the first one is statistically significant.

Q. And that's 4/25/02?

A. 4/10/02 and I think the earnings announcement is 4/24/02. It's actually 4/24/02.

There's a couple other examples like that.

1/30/02 you'll see it's a slight negative when AOL releases year-end results, failed to meet targets, but you'll see that there's some -- rather than a single analyst, there's like an analyst cut, an analyst cut, an analyst but and a bounce-back, and there's also some leakage in here that I didn't pick up just because this is still a class study.

You'll also see that in December there is a cut by Merrill and a cut by Robertson Stevens that both impact the stock pretty significantly, and so the market is really in November, December of '01 knocking the stock

S. Hakala

down, lowering expectations, and so when AOL comes out and misses its numbers on January 30th, 2002, the stock price effect is fairly muted.

Q. Let's turn to the July 18th and 19th Washington Post articles.

A. Okay.

MR. HALL: Of 02?

MR. GESSER: Of '02, yeah.

(Witness reviewing exhibit.)

BY MR. GESSER:

Q. Just before we get to that, the earlier statements that you were talking about Laura Martin, her concerns about the declining ad market, do you know if those were related to that AOL America Online division or the Time Warner division?

MR. HALL: Objection.

A. I don't know offhand.

Q. So July 18th and 19th, '02 --

MR. GESSER: We're up to Exhibit 14 and 15.

(Defendant's Exhibit Hakala 14, Washington Post article dated 7/18/02

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titled "Unconventional Transactions Boosted Sales", is marked for identification, as of this date.)

(Defendant's Exhibit Hakala 15, Washington Post article dated 7/19/02 titled "Creative Transactions Earned Team Rewards", is marked for identification, as of this date.)

MR. GESSER: Okay. Why don't we take a break so we can switch the tape.

THE VIDEOGRAPHER: The time is 12:47. We are going off the record.

(Lunch recess taken from 12:47 p.m. to 1:38 p.m.)

S. Hakala

AFTERNOON SESSION

(Time noted: 1:38 p.m.)

THE VIDEOGRAPHER: This is the start of the tape labeled No. 3.

The time is 1:38. We are back on the record.

* * *

SCOTT D. HAKALA, resumed and testified as follows:

CONTINUED EXAMINATION

BY MR. GESSER:

Q. You have in front of you documents marked Exhibit 14 and Exhibit 15; is that correct?

A. Yes.

Q. Do you recognize these documents?

A. Yes.

Q. These are The Washington Post articles that are referenced in your rebuttal report.

A. Yes.

Q. In your report you state that Professor Stoltz's conclusion that The Washington Post articles did not cause a

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materially statistically significant decline in AOL's stock prices, incomplete and inconsistent with the facts; is that right?

A. Yes.

Q. Okay. And you viewed these statements, the statements in these reports, as being corrections of information that was not disclosed in CSFB reports; is that correct?

A. Partially corrective and indicative of the kinds of news that would have come out in a CSFB report, yes.

Q. So what was disclosed to the market, starting with Exhibit 14, what was disclosed to the market about AOL in the July 18th, 2002 Washington Post article?

A. That the company had been involved in some transactions involving like Purchase Pro and other entities and that these transactions had the effect of boosting revenue and allowing AOL to be revenue targets, particularly in October of 2000 but some parts in 2001, and they had a few examples which were relatively modest in size of the types of accounting that was troubling.

S. Hakala

Q. Anything else that was new to the market that was disclosed in The Washington Post article?

MR. HALL: Objection.

A. Well, there is some allegation that this was improper; that because AOL had not taken all of the characteristics you need to book revenue, that they were booking revenue that they really wouldn't be able to book under accounting rules.

Q. So the market became aware of allegations of improper accounting?

A. Yes, but at a very limited scale. I mean most of this adds up to a very small percentage of the issues as I understood it.

Q. Did CSFB, in your view based on the allegations that you've seen, was CSFB aware of these accounting problems at AOL before this announcement?

A. I don't know the extent, but they were aware that there was an investigation into accounting issues and that there were questions about the quality and sustainability of some of the revenue.

S. Hakala

Q. And that is, the source for that allegation is from the complaint, paragraph 69; is that correct?

A. Primarily, yes.

Q. So going back to Exhibit 7, page 26, at the top, this is an email from July 11th, "In addition, I wasn't aware that AOL was under investigation and has suspended some employees for improper accounting activities. Some deals booked inappropriately inflated revenue."

A. Yes.

Q. Is that the information that you say CSFB was aware of that is the same information that is disclosed in The Washington Post article?

A. It's clearly not identical, it's not the same, but it's the type of information that we can draw reasonable analogies to some of The Washington Post disclosures, although I'm not even sure The Washington Post disclosure really sets out that there's an actual investigation.

Q. Do you know how many divisions AOL had in 2001 and 2002?

A. Not offhand.

S. Hakala

Q. Is there anything that would lead you to believe that the July 11th email is referring to inappropriate accounting activities relating to advertising revenue?

A. Yes.

Q. What does it say?

A. "Inappropriately inflated revenue."

Q. Okay. But what other revenue was a source for AOL at that time?

A. Well, they have subscriber revenue. There's some other sources as well.

Q. Time Warner, what --

A. Time Warner on the media side has its own advertising revenue and other sources of revenue.

Q. Is there anything that would lead you to believe that this wasn't a Time Warner accounting activity?

A. Yes.

Q. What is that?

A. Subsequent information that it was concentrated in AOL.

Q. Subsequent information that what was concentrated in AOL?

S. Hakala

A. That this issue of inflated revenues related to booking of ad revenue in AOL associated with dot com types of advertising.

Q. Again, you're just assuming that this is the same accounting activities that was later disclosed.

MR. HALL: Objection.

BY MR. GESSER:

Q. There's nothing about this email that would lead you to believe that they were talking about the America Online division --

A. I mean you can argue about facts but this is talking about layoffs in AOL. I think we're picking up static here. And not only is this talking about the layoffs in AOL, not Time Warner side, but then it's going on and talking about AOL is under investigation, has suspended some employees, and I think it's pretty clear this is talking about some of the inflation practices that AOL was engaged in with some of its dot com Internet partners.

Q. How is that clear?

A. Based on what we know subsequently about AOL. I mean you can argue the facts. I'm

S. Hakala

just drawing assumptions.

Q. No, I'm asking you how you're drawing that assumption.

Let's start with what makes you think that this -- looking at this, forget what happened subsequently, looking at the email, what makes you think that this is on the America Online side as opposed to the Time Warner side?

A. Because there were already rumors coming into the market about inappropriate accounting at some of the dot coms; that this talks about AOL, not AOL Time Warner, because I don't know of any allegations that I'm aware of subsequently or otherwise that says that the inflation of revenue was rampant or significant in anything but AOL.

Q. Well, this email doesn't say that there was rampant. It says some deals inappropriately inflated revenue.

A. And also trading irregularities, shorting some partner stocks.

Q. Right. And do you know if there were shorting partner stocks ever associated with either the America Online division or the Time

S. Hakala

Warner division?

A. America Online, yes. Partners with that division, yes, but Time Warner no.

Q. You don't know that.

A. No.

Q. You said there were rumors in 2001 about inappropriate accounting at the America Online division?

A. It wasn't really linked to America Online at that time. It was really linked to other telecom and other Internet providers who had relationships with AOL, but it hadn't been linked back to AOL yet at this point or had not been credibly so.

That there was just a very, very slight leakage, maybe in April, May that starting raising questions about ad revenue.

Q. April/May of?

A. 2001.

Q. 2001.

A. So there was something out there. It was sort of if I can use the phrase "pregnant" in the system that there may be some non-cash transfers that really inflate revenues or

S. Hakala

inflate earnings in some of these dot com advertising fields, but nothing specific to AOL at this point.

In fact I think some of the early investigations of the Purchase Pro investigation I think was already ongoing by this point.

Q. But if CSFB was a recipient of this email at this time, what would make them believe that this related to America Online as opposed to Time Warner?

MR. HALL: Objection.

A. Well, I didn't write this email.

Q. Okay.

A. But I'm just drawing inferences from the person who wrote this email and I'm assuming this email is referring to AOL, not to Time Warner because I think that's a reasonable inference. And if you want to argue facts and try the case --

Q. I'm just asking you -- all I'm asking is how you're drawing that. What makes you think that is a reasonable inference?

A. It says AOL inappropriate accounting activities, deals booked inappropriately

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inflated revenue. Those allegations later on proved to be in AOL. They're not in Time Warner as far as I know or at least they're not as pervasive in Time Warner.

And it also says suspended some employees so I'm tying this to part of the memo that's talking about layoffs.

Q. But earlier you thought that -- you said that there were 1,000 employees laid off in August; is that correct?

A. No. I don't know how many were laid off in June, but some were laid off in June, and then they announced in August 1,000 and then it ultimately was 1,700.

Q. So you think --

A. That it was at least probably in the hundreds at this point who at least were given notice that they were going to be laid off. I don't know if they laid off, but at least the word was out in AOL that layoffs were coming.

Q. And do you think some of those people -- sorry.

And those were people who were laid off because they were involved in inappropriate

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accounting?

MR. HALL: Objection.

A. I didn't say that. I said this just says that suspended some employees. I don't know how many of those were related to that issue.

Q. But the truth is you don't know whether this email is referring to the same accounting irregularities as were disclosed in The Washington Post article.

MR. HALL: Objection.

A. It's extremely highly probable. It's basically -- and it's a reasonable inference that I would draw and it's an assumption I'm making.

We haven't got fact discovery yet and I certainly haven't reviewed fact discovery. That's not where we are. We're a class cert.

Q. But you're not a lawyer.

A. And I'm not a lawyer and I'm not going to argue the law and, you know, but I have a foundation for what I'm assuming.

Q. So you're telling me that you viewed as a reasonable assumption that in July of 2001,

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AOL was under investigation for some accounting activities which were the same accounting activities that were only disclosed a year later in The Washington Post article.

MR. HALL: Objection.

A. Well, I think that's now known in retrospect.

Q. That AOL was under investigation for the same accounting irregularities a year earlier?

A. Really it was Purchase Pro and other entities were in investigation already by this point, but since they were the counterparties to AOL, AOL was also part of that investigation.

Q. In July of '01.

A. Yes. It may have predated that, but I don't know when it started and I haven't looked at that lately. I think that's not publicly known.

Q. And the amount of the deals that are discussed, I think you indicated were modest in size; is that right?

MR. HALL: Objection.

A. In The Washington Post article, yes.

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Later on, what came on later in July and then in August of 2002 suggests the magnitude was much higher so Washington Post just had some anecdotal examples.

Q. But none of those examples were, as far as you know, were known to CSFB.

MR. HALL: Objection.

A. I don't know. All I know is CSFB knew some employees were suspended for inappropriate accounting and they were under investigation.

Q. And do you know -- do you have a view as to whether that investigation is the same investigation that was announced on July 25th?

MR. HALL: Objection.

A. I'm not certain, but my understanding is that this was the preliminary aspect of it and the counterparties of AOL were already under investigation at this time. So if you follow the paper trail, it's going to lead to AOL at this point.

It's not news that Purchase Pro and some of these other entities I think were under investigation as early as June or earlier in

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2001.

Q. What was your T statistic for July 18th?

A. July 18th?

Q. Yes.

A. Overnight or the --

Q. Close to close.

A. -- close to close?

It was modest. I don't even think it was one.

Q. So that's not significant at the 90 percent confidence level.

A. No.

Q. And yet you viewed this day as being a day where there was a material disclosure; is that correct?

A. There was leakage of the relevant truth but then there was offsetting rebuttal by the company and by analysts later in the day that bounced the stock back.

This is a particular day where I had intraday data and I happen to know that the stock dropped significantly overnight and then it rebounded on statements and denials by the

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company and by analysts on both days.

So you had this phenomena where you have this overnight drop and a reaction to the news, and then the company and certain analysts counterattacked and it basically reinflated the stock price.

So if you did an intraday trading analysis on this, this is unambiguously a significant event. But you have two significant events that are offsetting each other in the 24-hour window --

Q. So the one event --

A. -- causing the one day, the 24-hour effect to be not statistically significant.

This is an example why relying on statistical significance on its face is not a very good thing when you know that there's two events occurring in the same 24-hour period.

Q. Okay. So the two events are the disclosure of the alleged accounting irregularities in The Washington Post article --

A. Yes.

Q. -- which occurred before the market opened.

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A. Well before I think.

Q. Well before.

A. Overnight.

Q. And the second event is the denial of the allegations by AOL; is that correct?

A. And by analysts, and also the attempt to indicate that the issues being raised were immaterial overall because they pointed to the fact that Washington Post only had a few anecdotal examples. It did not have what I would call the universe of the problem.

Q. And you view those as being separate events as opposed to being part of the same event?

A. They are part of the same event but when one piece of the information causes the stock to fall significantly and the other causes it to rise significantly and the trading volume increases significantly, we cannot say that that was not a material event. That's why looking at the stock price movement by itself over a 24-hour window is often misleading as a determination of materiality.

Q. Okay. If you look at page 9 of the

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July 18th report.

A. Okay.

Q. The second to last paragraph.

A. Yes.

Q. It says, "When asked about the financial arrangement, AOL declined to make any documents available but confirmed that it books the sale of eBay ads as AOL's own revenue which it maintained is the proper accounting method."

A. Yes.

Q. Do you see on the next page, third full paragraph, "AOL said it was appropriate for it to book eBay's revenue as AOL's own"?

A. Yes.

Q. And that the last paragraph, "AOL, however, said that taking all the aspects of the deal into consideration, it was reasonable to conclude that it was the principal in the transaction and it rejected the expert's opinions saying they didn't have all the information to make a proper determination. Ernst & Young, AOL's outside auditor, reviewed the transaction and confirmed its accounting."

A. Yes.

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Q. So the article itself contains the denial of the allegations by AOL; isn't that correct?

MR. HALL: Objection.

A. Not the full extent. It contained some and that helped mute the impact of the article, that is true, but the formal denial, the press release and the other counterattacks really occurred later in the afternoon. I think it was early afternoon of trading on the 18th.

Q. How would one unpackage the denial that occurs in the actual article from the impact of the accounting statement?

A. Well, in the article itself you can't other than to draw a reasonable inference that the disclosure of improper accounting without that denial would probably or most likely have led to a more significant effect overnight than it did.

What we do know, however, is that the company and certain analysts then subsequently chiming in and adopting the company's position provided cover to the company or reinforced the company's position and allowed the stock to

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rebound during trading during the day of the 18th.

Q. But isn't that --

A. I think there's a whole bunch of articles about that even at the end of the day.

Q. But isn't that how news reaches the market, is that there is some event and the company may comment or an analyst may comment, and to look at how that event affects the stock price is to look at the price of the stock over that period of time in which all those things are happening to determine the effect?

I mean why in this particular case do you isolate the statement from the company's comments on the statement or analyst comments on the statement?

MR. HALL: Objection.

A. Because I'm saying that the statement that the company was under investigation, which is by the way not disclosed necessarily in Washington Post if you'll notice, that's not in there, but that the company may have had a few bad deals where they booked some revenue improperly and the company denies it's improper.

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You wouldn't expect as large of an effect as the company is under investigation, has suspended some employees. That to me is materially more significant from a qualitative standpoint.

But additionally, when the company counterattacks and the analyst counterattacks, those are really separate pieces of information. Think of it in terms a leakage event, what we call a junk diffusing process. Each of those individual statements and disclosures would be considered an independent jump.

So in a time stamped, you know, minute by minute event study you might unpack that completely or you could look at it in a consolidated basis, but nevertheless I mean this suggests that this is material information, it's not immaterial. People traded on this. Regardless of the statistical significance of the stock price, people traded on this.

Q. But the analysts who looked, analyst reports that came out to say viewed the statement as being not material.

A. No, overblown.

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Q. Overblown.

A. Right.

Q. Because the amount of revenue involved was --

A. Was small.

But I think this doesn't tell you that they're under investigation and suspended some employees for improper accounting.

In fact this says that they didn't do anything wrong.

Q. Although it does say that this may lead to an investigation.

A. It may lead is completely different from it is under investigation, they have already suspended some employees. That's a pretty dramatic act, so, you know, that's closer to what's announced on July 24th and later in July.

Q. So let's take a look at that July 24th article.

You found a statistically significant negative return for AOL on July 24th, 2002?

A. 24th and 25th.

Q. What do you attribute the negative

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return on the 24th to?

A. There was news that AOL was likely to have disappointing earnings and the market began to anticipate that after the close of trading, that the news was not going to be positive so really the event effect is the 25th.

Q. Okay. All right. So let's look at the 25th.

MR. GESSER: Let's mark as Exhibit 16.

(Defendants' Exhibit Hakala 16, New York Times article dated 7/25/02 titled "AOL Accounts Under Scrutiny From The SEC", is marked for identification, as of this date.)

BY MR. GESSER:

Q. So what was the new news, negative news at the market on the 25th?

A. The SEC had begun an investigation into accounting at its AOL division.

Q. Is there any indication from this article when that investigation began?

A. This says that it began in response to The Washington Post article, but I believe

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that because of the counterparty investigations in fact the issue was being looked at, maybe not with AOL so much, a year earlier, but at least this article thought it began after The Washington Post article.

Q. And what was disclosed in this article that wasn't -- hadn't been disclosed in either the July 19th or the July 18th articles?

A. That there's an SEC inquiry.

Q. That was the significantly new news?

A. Yeah. I mean there was an earnings release, but actually if you really, if you really deconstruct the earnings release, it wasn't too bad. In fact I think they slightly did better than expected. So if you look at the earnings release on its face, it probably is a net positive to neutral.

What the market apparently is reacting to and what a lot of the news stories on the 25th suggest is that the market was reacting to the SEC investigation.

Q. Can you describe the methodology you used for your event study that was conducted in March?

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A. Sure. It's really a very simple principle. Essentially what the principle is, is that there's two alternative approaches to event studies, two global approaches.

One is to find a quote, unquote, clean period outside the period of interest where presumably the company is still the same company and study how the company stock moves during this quote, unquote, clean period.

Clean periods means there is no significant events, no extreme events, no outliers. A lot of people don't realize, if there's extreme events or outliers that contaminate the control period or the clean period, it's not a clean period.

The alternative methodology is to say I'm going to study the period of interest, but if I study the period of interest, I have to control for at least all the relevant events that occur in the period of interest, but it turns out mathematically and statistically that's not enough.

Essentially in the analogy it goes like this: Suppose that one wanted to test to

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see a new therapeutic pain reliever actually was safe and efficacious. In order to do that, the standard methodology that the FDA would require is what's called a double blind study where you would basically have a group of patients come in who all report some kind of chronic pain and you would divide them up let's say 100 patients in one group, 100 patients in another group and the people who are administering the project don't know which patient is in which group, and they have little pills and bottles or whatever and they give each patient a pill. And at the end of the study they take what are called pain threshold tests and pain scores over time and they measure for those taking the placebo pill and those taking the other pill, how their response to pain changes over time in response, both immediately after taking the pharmaceutical product, let's say in the next hour or next three hours, as well as over prolonged period let's say a week, might come in once a week or might come in twice a week. That's a true blind double study. Your control group sets your baseline and your control group must be composed

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of people who are not taking the medication of interest but don't know that.

Now if you're doing a double blind study, the other part of it is those people can't also be taking other pain medications. They can't be taking Tylenol, they can't be taking aspirin, they can't be taking Vioxx, they can't be taking any other pain medications. That will contaminate the results and it will cause the efficacy of the drug to be materially understated in the control study.

The same principle applies here. If I want to study what effect an event had on the stock price, my control group must be composed of a sample of days when there is no suspected potentially material news. It doesn't matter whether the news caused the stock to increase, decrease or increase trading volume. It's just it falls within the criteria of the kinds of news that investors might be interested in or concerned about and therefore I should control about it.

Q. So what did you do?

A. So what I did then was I basically

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started with what we call a punch list which starts with in the federal register as I outline in the report, a list of the types of events that are potentially material and would normally or could potentially cause a company listed on let's say NASDAQ to notify the NASD in advance of any upcoming press release and would ordinarily cause them to disclose it or cause a press release or some other thing.

So we start with that punch list and then we fill that out by adding analyst reports if and only when the analyst is upgrading, downgrading, changing earnings expectations or otherwise changing something materially, altering something.

We do not put in 10-Ks and 10-Qs because our prior experience is that those tend not to be viewed as material by investors unless there's something specific in those documents that is unique or different than what was in the earnings conference call. So those only go in when we find alternative news.

We go through the news on Factiva, LexisNexis, the analyst reports that we have

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available, we identify the news and on those days where we find some piece of news or some analyst report that we know falls within our punch list, and our rule is to be over inclusive rather than under inclusive and there's a philosophical and as well a statistical reason for doing that, then that's a day where we're going to put a -- we're going to call that day potentially material event day. We're going to control for it.

Q. So you go through and you take the class period --

A. Yes.

Q. -- and from the class period you identify the total number of trading days; is that right?

A. Yes. In this case we go outside the class period but not too far. And because of the change in the company, we start on the day of the merger and then we run to what, about September something, about 90 days after the end of the class period.

Q. Okay. And then you identify in those trading days a certain number of, what do you

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call them?

A. Days with potentially material news.

Q. Days with potentially material news.

A. Yes.

Q. Okay. Got it.

All right. Then what do you do?

A. That's our, that's our, that's the group that is, quote, unquote, contaminated by news, so we're going to study how the stock moved on those days against our control group where our control group is the days when there is not potentially material news identified in our search.

Q. Okay. And how many days with potentially material news did you have in this case?

A. 161. And that's probably limited. I know if I went to a final event study and a final report it would be more, but at least for now 161.

Q. Did you do the same analysis when you were doing your work in the In Re AOL case?

MR. HALL: Objection.

A. We used some of the same information

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but we did not do the same -- we did the same methodology but we did not use exactly the same search because the focus in this case was more on analysts and analyst impacts, so we were more conscious and careful to look for analyst types of events than we would have in AOL Time Warner.

Q. Okay.

A. The other thing is that I think we were probably more thorough in some other ways in AOL Time Warner because of the size and magnitude of the case. I spent a lot more time on that. I mean I remember literally spending days going literally box by box with an attorney through each piece of news and making sure it fit within the protocol, it didn't fit, why, that kind of thing.

Q. So once you've got your 161 potentially material news days --

A. Yes.

Q. -- then what do you do? What's the next step in conducting the event study?

A. The next step is to identify reasonable market indices, market industry indices to build what's called a market model.

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Q. How do you go about doing that?

A. Well, what you do is you look at what are the types of companies that are mentioned as competitors or are in the same competitive space or driven by the same kinds of demand fundamentals.

So in this case we really did two things.

One is we looked for market indices that were broad market indices as well as an industry type indice, which in this case was the media indice which is a very broad index of a lot of different media companies where AOL Time Warner is really a very small part of that index.

We started with those as our base and then we identified two sets of companies; companies that are Internet, Internet marketing, Internet advertising related in some form or fashion as our tech index, and then we looked at another group of companies which were media companies more closely tied to or mentioned as peer companies or guideline companies for valuing AOL Time Warner in various analyst

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reports.

Q. Sorry. There's you have two market and two industry indices; is that right?

A. Yeah, one broad market index and one narrower market index focused on the media stocks. Companies in the media market.

Q. And then two industry indices.

A. Yes.

Q. And --

A. Now we had a lot more to select from, but that's ultimately what we settled on.

Q. Okay. And how did you settle on those? What was it about those that --

A. Essentially that's a goodness of fit criteria and a match. We're looking for indices that incrementally explain more on themselves and aren't essentially dominated by or knocked out, if you will, by another index.

In other words, I've run two indices together in the same event regression and one has a negative sign, that's clear that one is being knocked out or completely overwhelmed by the other.

If one has almost no significance at

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all like a T statistic of .5 or under .1, that would be a candidate for throwing that out.

Q. Did you include Vivendi in your competitor index? I mean, sorry, in your media index?

A. Yes, Vivendi is in the index.

Q. Do you remember if you included that in the index that you -- in the study that you did in In Re AOL?

A. In In Re AOL, that's a little different animal because we were really taking what Dr. Kleidon was doing and in a sense upgrading it or improving. We were in a sense fixing his methodology.

He used the same methodology I used but rather than controlling for all of events, he only controlled for events mentioned in the complaint and so we essentially upgraded his analysis.

I don't remember us adding anything to his index, but I think we dropped some companies out of his index that were just not significant.

But, you know, the short answer, I

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don't know. I might have.

Q. But that index wasn't put together by you is that what you're saying?

A. Yeah, we were essentially starting with what Dr. Kleidon had already done. We weren't starting from scratch.

Q. And once you put together these indices, then what do you do?

A. Well, now we're going to run an integrated regression and the integrated regression is going to be a regression that shows how the stock price of AOL Time Warner moves as a function of identified company specific news on identified potentially material news dates and as a function of market and industry indices on other dates, and then attempt to identify what the standard error is on the non-event days.

So it's a single statistical analysis that does all of that together. It takes the events and it takes the market indices and it takes the stock price movements of AOL throughout this entire time period that we're studying, puts them all together and comes out

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with a set of statistical results.

Q. Okay. Is there a name for that kind of analysis? Is that a one-pass analysis?

A. Some people call it one-pass. The sort of -- different people have different words for it. It --

Q. What do you call it?

A. In the statistics literature it's called intervention analysis. In the finance literature it's called the event parameter methodology or the dummy variable methodology.

Q. Okay. I'm going to call it the dummy variable methodology, okay?

A. That's the worst of the three names.

Q. Would you prefer I called it one-pass?

A. It should be called intervention analysis because it's really -- the true genesis of it is Box and Tiao 1975 and it's called intervention analysis.

Q. Okay. Did you use the same methodology in your March report as you did in your rebuttal report for doing your intervention analysis?

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A. Yes, but the only difference is in the rebuttal report in this case I'm merely looking at the overnight close to open numbers, so I'm really looking at a breakout of the event study, and to the extent that some of the events I've identified in my normal event study did not occur overnight, they're not flagged.

So I had a subset of the events in the broader event study that I controlled for and I only looked at changes in prices from close to open, and because some of the market indices are not available at on an open -- close to open basis, some of those could not be used.

Q. How are overnight prices set?

A. Overnight prices are basically set where Bloomberg at this point generally reported what's called a last trade price, which usually is the official closing price but isn't always, and then it reports an opening price, which is usually the first price quote out of the box or first price of the first trade at the opening of trading the next morning.

Now with sort of the spillover of Island ECN and some of these others, there's

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some spillover after hours. A lot of the after hour prices don't show up in Bloomberg.

Q. And where did AOL trade, the New York Stock Exchange?

A. New York Stock Exchange.

Q. Do you know if the opening price on the New York Stock Exchange is set by a specialist or set by the first trade?

A. This is first trade. This isn't a bid or ask.

Q. Are you aware that certain academic articles discuss that there's a higher volatility and unreliability for opening prices?

MR. HALL: Objection.

A. There is academic articles that suggest that opening prices, yes, yes, that's because the opening prices represent the first trades and may not reflect how the market is fully going to anticipate and react to overnight news, so there can be more volatility in prices in the first half hour to hour of trading. Yes, I'm aware of that.

All that means is that there's a higher standard error in that regression than

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there would be in another regression.

Q. Isn't it true that you used to use a two-pass approach in some of your event study methodologies for past litigation?

MR. HALL: Objection.

A. No. I've always used the integrated methodology.

If I used a two-pass, the second pass was not what your would think it is. The second pass was either extending the regression results to a period where you couldn't run the regression reliably or it was to -- you have to run a first regression and then adjust the standard errors for changes in volatility over time. That's a process called conditional heteroscedasticity. I don't ever remember running -- the traditional CAR method, which is what we call the two-pass method, I have never adopted that method and I will tell you since 1980 I knew there were problems with that method.

In other words, given my academic training, I would never have used the CAR method because I would have immediately known that it

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was wrong, that there were problems statistically with it, at least for a single company event study. In the Econometric Times series literature that methodology is not an accepted method.

Q. All right. Well, are you aware that there are studies dealing with single companies which use the event study methodology that Professor Stulz used in his analysis in his report in this case?

A. Well --

MR. HALL: Objection.

A. -- Professor Stulz used an event parameter approach if I'm not mistaken.

Q. Well, however you want to describe it but --

A. Well, yes, yes, there are academic studies that use it and there is a split. In fact there's a review article that points out that many of the event studies fail to control for outliers even though it is well-known that you really should. That's more of an indictment of what I would call the academic applied finance literature.

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Q. Once you have run your, now I'm forgetting what we agreed to call it.

A. Intervention.

Q. Your intervention analysis, what's the output from that?

A. The output is a regression output that estimates the percentage of the variance explained, which is called the R squared or centered R squared, the percentage of the variance explained adjusted for the loss of degrees of freedom with all the events I controlled for. That's called the adjusted R squared.

It produces a regression F test, which is a test for whether the regression is arbitrary or random or whether it does something. It will produce a standard error before and after.

I control for marketing industry forces and events and then it will give an estimate of the effect of each variable in the regression, which includes each of the market and industry indices and then each of the events, and then it will give a standard error